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Mexico's International Telecommunications Policy: Origins, the WTO Dispute, and Future Challenges

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Abstract

Mexico is by far Latin America's largest trader and the country with the most free trade agreements. Notwithstanding the success of its trade policy, the liberalization of its telecommunications sector was limited and generated a dispute at the WTO. This article offers an overview of Mexico's trade policy, with special emphasis on its policy regarding trade in telecommunications services and the 2002-2004 Mexico-United States dispute over telecommunications in the WTO. The dispute is the first one over trade in telecommunications services at the WTO and has generated interest among many developed and developing countries.

Keywords: Mexico; trade policy, telecommunications policy; GATS; dispute

Article abbreviation: Mexico's International Telecommunications Policy

Resumen

México es la principal potencia comercial latinoamericana y el país con el mayor número de tratados de libre comercio. A pesar del éxito de su política comercial, la liberalización de su sector de telecomunicaciones fue limitado y generó una disputa en el marco de la OMC. El presente artículo ofrece una visión general de la política comercial de México, con especial énfasis en la política relativa al comercio en los servicios de telecomunicaciones y la disputa sobre telecomunicaciones México-Estados Unidos en la OMC (2002-2004). Esta disputa es la primera en su tipo y ha generado mucho interés entre varios países desarrollados y en desarrollo.

Palabras clave: política comercial, política de telecomunicaciones; GATS; disputa

Abreviación de artículo: La Política Internacional de Telecomunicaciones de México

Introduction

Mexico's trade liberalization in telecommunications services has been the subject of significant discussions at both the domestic and international levels. Topics such as the adequate speed and depth of liberalization and the role of the incumbent generate controversy. This article provides a brief overview of Mexico's trade strategy, assessing some of the reasons that led to the limited liberalization of telecommunications and the ensuing dispute over trade in telecommunications services at the World Trade Organization (WTO).

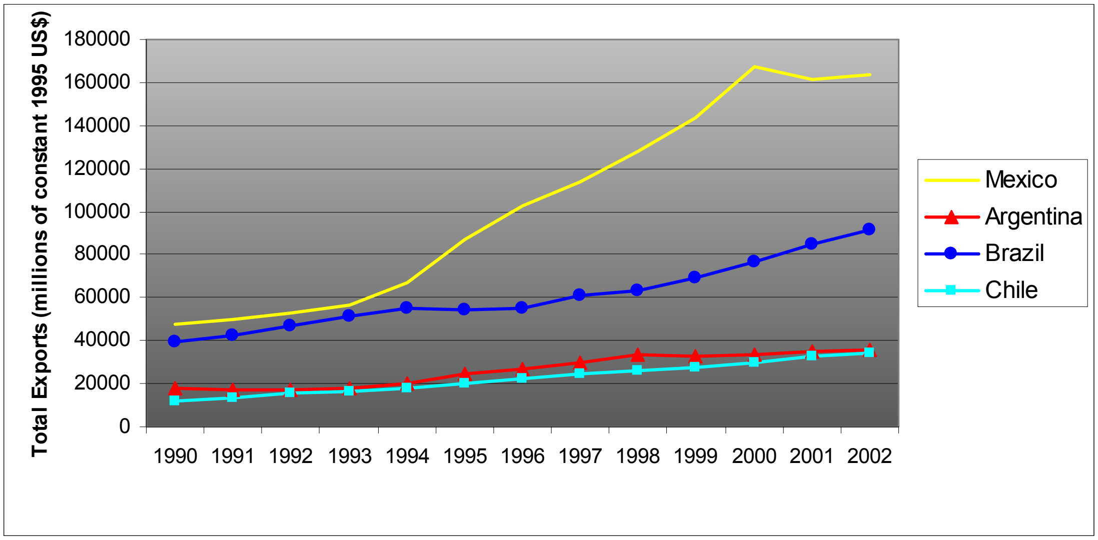
The first section presents stylized facts on trade policy developments in Mexico, given that a proper understanding of the particulars of the liberalization of trade in telecommunications services requires an understanding of Mexican trade policy reforms and the logic behind them. The second section provides a brief review of Mexico's international telecommunications commitments, the third one explains the rationale behind the trade strategy and the role that telecommunications played within it, and the fourth section highlights the contending positions between Mexico and the U.S. over Mexico's telecommunication liberalization commitments under the General Agreement on Trade in Services (GATS), which were reviewed by a panel under the WTO's Dispute Settlement Understanding from 2002 to 2004. The dispute is the first one over trade in telecommunications services reviewed by a WTO panel, and has generated great interest among both developing and developed countries that have also undertaken commitments under GATS. The final section concludes.

1. The Trade Policy Context

Mexico is the major trade power in Latin America. In 2002 its exports surpassed those of the major Latin American economies. (Figure 1)

F I G U R E 1

TOTAL EXPORTS: MEXICO SELECTED LATIN AMERICAN COUNTRIES, 1990-2002



Source: World Development Indicators. World Bank, 2004.

As part of its aggressive trade liberalization strategy Mexico negotiated a significant number of free trade agreements since the early 1990, and as of mid-2004 it had free trade agreements with 43 countries. It is also a founding member of the WTO, an active participant in the multilateral trade negotiations linked with the Doha Development Agenda, and an important player in the negotiations aimed at establishing the Free Trade Area of the Americas (FTAA) (Table1).

TABLE 1

KEY DEVELOPMENTS IN MEXICAN TRADE POLICY

YEAR (*)	EVENT
1986	**GATT** ENTRY
1993	**APEC** ENTRY
1994	**NAFTA** (UNITED STATES AND CANADA) **OECD** ENTRY
1995	**FTA-G3** (COLOMBIA AND VENEZUELA) **FTA MEXICO-COSTA RICA** **FTA MEXICO-BOLIVIA**
1998	**FTA MEXICO-NICARAGUA**
1999	**FTA MEXICO-CHILE**
2000	**EU ASSOCIATION AGREEMENT** **FTA MEXICO-ISRAEL**
2001	**FTA MEXICO – NORTHERN TRIANGLE** (GUATEMALA, HONDURAS AND EL SALVADOR) **FTA - EFTA** (ICELAND, NORWAY, LIECHTENSTEIN AND SWITZERLAND)
2004	**FTA MEXICO-URUGUAY**
2005	**FTA MÉXICO-JAPAN**

(*) Refers to the year when the agreement entered into force.
Source: Based on the Secretaría de Economía Web Page: http://www.economia-snci.gob.mx

The transformation of Mexico's export sector may undoubtedly be qualified as a radical one, given that until the early 1980's the economy was closed. Mexico's closed economy performed well in the post- World War II era, with the agricultural sector growing at an annual average rate of 7.4% between 1940 and 1955, although there was exchange rate instability and inflation (Solis 1981, 76-90). The 1954 peso devaluation ushered in an era of stability and growth; from 1955 to 1970 average annual rate of growth of agriculture fell to only 3%, but manufactures grew at 8.6% and electricity at 11.6% (Solís 1981, 169).

During the 1958-1970 period, known as Stabilizing Development, the Mexican economy grew at an average annual rate of 6.8%, with an average annual inflation of only 2.5%. The outstanding performance was due in large part to close coordination between the Finance Ministry and the Central Bank, and to the collaboration between government, the private sector and labor organizations under a corporatist system of interest representation (Ortiz Mena 1998, Cornelius 1991).

Prudent macroeconomic management and close collaboration between the public and private sector gave way to populist economic policies during the Luis Echeverría administration (1970-1976), which ended in economic crisis, a devaluation of the peso, and strained relations between government and business (Cárdenas 1996, 93-106). The José López Portillo administration (1976-

1982) immediately sought reconciliation between the public and private sector and complied with the requirements of an International Monetary Fund stabilization program that started in late 1976. However, the announcement of the discovery of vast new oil reserves in early 1978 led the government to cast aside the cautious economic policies followed in 1977, and it embarked on an ambitious economic development program aimed at attaining high rates of growth based on oil export revenues and foreign loans. This meant that in the late 1970s and early 1980s, Mexico gambled on a continued upward trend of international oil prices and cheap international loans. Both trends turned against Mexico's interests in 1981-1982 and resulted in an economic crisis of major proportions (Cárdenas 1996, 106-117).

During the Miguel de la Madrid administration (1982-1988) the government sought to stabilize the economy and provide a basis for renewed growth. As part of the stabilization program, tariffs were reduced and the amount of products requiring an import license declined: trade liberalization had come about by *force majeur*, rather than as the result of political consensus and programmed, gradual liberalization. In addition to engaging in unilateral liberalization, the Mexican government decided to join the General Agreement on Tariffs and Trade (GATT) in 1986, after it had balked at the last minute in 1979 (Ortiz Mena L.N. 2005). These reforms resulted in a radical change of Mexico's export profile: whereas in 1982 oil exports constituted 78% of total exports, by 1986 that figure was reduced to 39% (Weintraub 1988, 13).

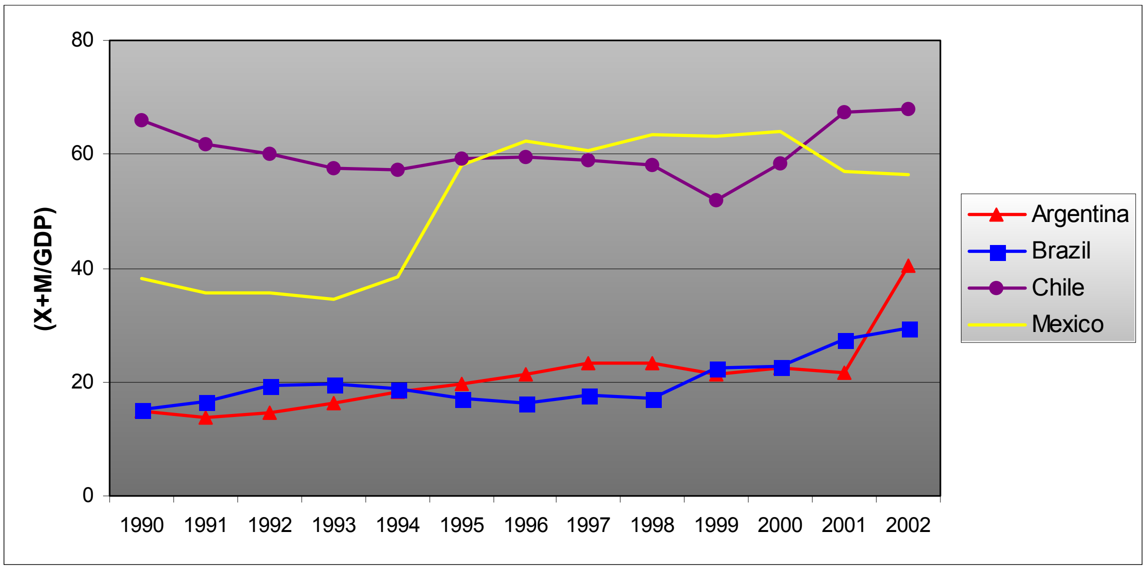
The Carlos Salinas administration (1988-1994) inherited an economy that had stabilized and whose export profile had changed, but was not growing. The immediate challenge was to re-negotiate the terms of the foreign debt service, and then to find fresh resources to foster sustained economic growth. Given that at the time foreign banks and international financial institutions were loath to continue granting loans to developing countries, the most likely financial source available for Mexico was Foreign Direct Investment (FDI).

In order to attract FDI, the Mexican government needed to convince foreign investors that it would maintain a sound economic policy and that Mexican exports would have guaranteed access to the world's major markets, the reason for this being that the majority of FDI that would flow into Mexico would be associated with trade for re-export to third markets. In this sense, the North American Free Trade Agreement (NAFTA), which was negotiated from 1990 to 1992 and entered into force in January 1994, was of paramount importance: it increased the costs of economic policy reversal for the Mexican government, provided ample protection to foreign investors under international arbitration provisions that would govern investor-State disputes, and offered guaranteed access to the U.S. market. NAFTA represented the full embrace, in earnest, of free trade by the Mexican government, as opposed to the forced changes undertaken during the 1980's (Ortiz Mena L.N. 2004).[1]

The trade policy reforms carried out under Salinas resulted in a major increase in trade volumes, as can be seen in Figure 2, and concomitantly increased the trade openness coefficient of the Mexican economy, so that by the early 1990s it was one of the most open economies in Latin America.

F I G U R E 2

SELECTED LATIN AMERICAN ECONOMIES: TRADE OPENNESS COEFFICIENT (X+M/GDP), 1990-2002



Source: World Development Indicators. World Bank, 2004.

Despite the forced liberalization during the 1980's and the more proactive strategy of the 1990's, whose standard bearer is NAFTA, the liberalization of trade in telecommunications services remained quite limited. In the next section we survey the extent of liberalization in that sector, and in the third one we offer some explanations for the reticent stance toward telecommunications liberalization.

[1] As shown in Table I, Mexico signed a great deal of free trade agreements, but in fact the only ones that have a great economic significance are NAFTA and the trade agreement with the European Union.

2. An Overview of Mexico's International Agreements on Telecommunications

Mexico has signed an important number of international telecommunications agreements, given that telecommunications services are eminently international activities and therefore need international legal instruments to regulate them. In this section, we offer an overview of Mexico's international agreements on telecommunications, highlighting the type of commitments undertaken under regional trade agreements, and those in GATS.

2.1 Type of Agreements

For ease of reference, agreements are classified in two categories: binding vs. non-binding, and bilateral vs. multilateral agreements. Tables 2 and 3 show the type of agreement present in each category.[2]

TABLE 2

NON-BINDING TELECOMMUNICATION AGREEMENTS

	Bilateral	Multilateral
Non Binding	An important number of: ▪ Cooperation Agreements ▪Memorandums of Understanding ▪ Protocols ▪ Declarations (Mostly with the U.S.)	▪ Declarations ▪ Cooperation Agreements ▪ (APEC, CITEL, REGULATEL, AHCIET, among others) ▪ OECD

SOURCE: RODRÍGUEZ 2003.

[2] The list is merely illustrative and not exhaustive.

TABLE 3

BINDING TELECOMMUNICATION AGREEMENTS

	Bilateral	Multilateral
Binding	Free Trade Agreements	NAFTA
	COSTA RICA	Mexico-European Union Association Agreement
	BOLIVIA	EFTA-FTA
	NICARAGUA	GATT- WTO "Agreement on Basic Telecommunications' Services"
	CHILE	International Telecommunications Union (ITU)

Source: Rodríguez, 2003.

The remainder of this section reviews the type of agreements listed in Tables 2 and 3.

2.2 Telecommunications in Free Trade Agreements

Most of Mexico's free trade agreements contain provisions governing trade in telecommunications services and constitute the bulk of the binding agreements in the telecommunications field.[3] In general, chapters on telecommunications include the following issues (Rodríguez 2003): network use and access; flexibility and transparency regarding network connections, and non-discrimination for those using access to networks; value-added services; and the normalization of terminal equipment (that is, flexibility to establish connections to public telecommunications networks).

These commitments are quite limited in terms of the potential scope and coverage of telecommunications liberalization, especially in light of the liberalization carried out in most other areas of the Mexican economy

[3] Mexico's FTAs that contain provisions on telecommunications are: NAFTA, G-3, Costa Rica, Bolivia, Nicaragua, Chile, Uruguay, Northern Triangle, Israel, EFTA, and the European Union Association Agreement. Please refer to Table 1 for a complete listing of Mexican free trade agreements.

(Hufbauer and Schott 1993, Cameron and Tomlin 2000). International participation in basic telecommunications services was not covered under these free trade agreements (FTAs); and foreign participation is allowed only in value added services. The liberalization of the telecommunications sector was thus limited basically to trade in goods, i.e. sales of telecommunications equipment (Mariscal 2001).

Taking into consideration the significant effect of telecommunications services on productivity levels in many economic sectors, the provision of such services at internationally competitive prices and quality was an imperative for Mexico's export-driven growth strategy.

International services providers entered into competition in the Mexican telecommunications market just after the third quarter of 1996, when the Long Distance Rules and the International Long Distance Rules (ILDR) were issued.

The limited telecommunications liberalization was intended to promote investment for new infrastructure and to digitalize the existing national telephone networks, by limiting competition for a limited time and allowing investors to reduce the risk that returns on their investments would be inadequate. Further liberalization expected by major international players was negotiated on a multilateral basis under the aegis of the WTO.

2.3 Telecommunications at the WTO

2.3.1 Principles of the Negotiating Process

The WTO constitutes the institutional and legal basis of the multilateral trading system. The system is based on fundamental principles, which allow exchange across borders and award legal certainty to WTO members. Among these principles are non-discrimination (most-favored nation treatment and national treatment), predictable and gradually improved market access, and fair competition.

GATS is a horizontal instrument, meaning it applies to different kinds of services and intangible goods. It is made up of articles that describe the general scope of obligations of member countries, as well as several annexes including the one for telecommunications services. It is founded on the same fundamental principles that rule the multilateral trading system, and awards members the right to regulate the supply of services, recognizes the increasing involvement of developing countries in the trade in services, and grants them the right to establish certain safeguards to foster the development of a strong services sector so they can compete in world markets in the future. The liberalization of trade in services is done via a "positive list" approach, whereby countries list the scope and coverage of the liberalization offer, and items not included in the list are exempted from liberalization. This contrast with the "negative list" approach followed under NAFTA, where exclusions are set out in a list, and the items not listed therein are accordingly liberalized.

2.3.2 Telecommunications in GATS

The telecommunications sector is explicitly dealt with in the GATS' Telecommunications Annex. It refers mainly to telecommunications' role as a signal transportation means, and applies to a member's measures which directly affect the access to networks and public telecommunications transport services and their use.[4]

Based on GATS tenets, member countries decided in 1994 to initiate negotiations on basic telecommunications issues, and the agreement reached entered into force in February 1998. One of the main reasons for the long time taken to reach an agreement was the U.S. insistence on including the "Accounting Rates" issue. This controversial issue refers to the system employed to dispatch international traffic and the rates paid for this service, and is precisely the central theme of the Mexico-U.S. trade dispute that led to the establishment of the telecommunications dispute settlement panel, which we will analyze further on.

As an outcome of these negotiations, commitments were obtained from 69 countries in 1997; these negotiations represent the greatest effort to date to allow the supply of telecommunications services on a world level.

2.3.3 Mexico's Commitments Under the 1997 GATS Agreement on Basic Telecommunications

At the WTO, Mexico's commitments went beyond those undertaken in NAFTA and similar agreements. In 1994, Mexico ratified the WTO's GATS. The following are, broadly speaking, Mexico's commitments on telecommunications derived from GATS (WTO-GATS 1997):

- International traffic shall be routed by an enterprise holding a concession from the Ministry of Communications and Transportation (Secretaría de Comunicaciones y Transportes, SCT).
- Foreign governments will not be allowed to participate in an enterprise created under Mexican law, nor will they be authorized to offer telecommunications services.
- Foreign direct investment will be allowed up to 49% in an enterprise established under Mexican law.

[4] "Telecommunications Annex" 2. Scope a) WTO, Annex 1B, General Agreement on Rates and Trade" 1994.

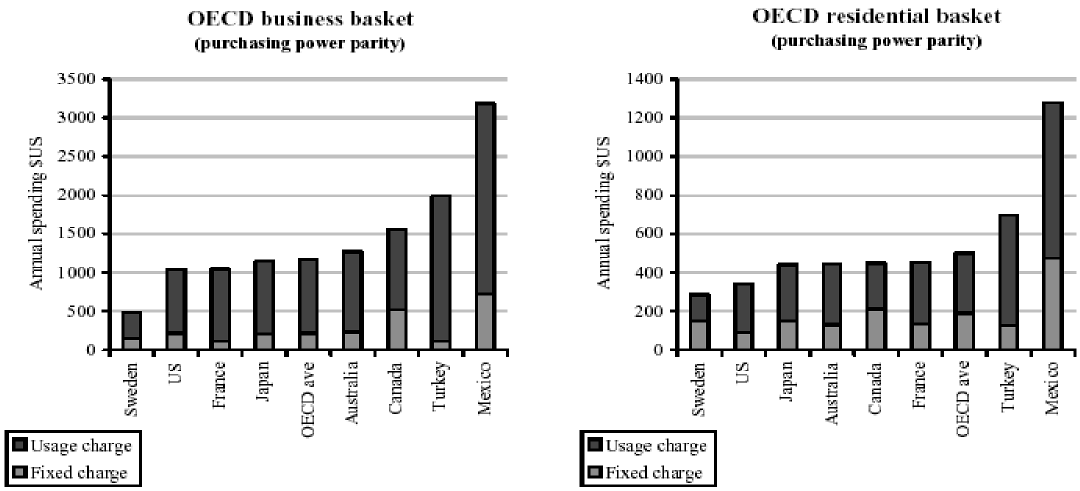
- Universal service: every WTO member has the right to define the kind of obligation regarding universal service. Such obligations will not be considered as anticompetitive practices *per se*, if they are managed in a transparent, non-discriminatory manner and are competitively neutral.
- Preventing anticompetitive practices in telecommunications: adequate measures will be observed, so as to prevent suppliers from becoming –individually or as a group- a main supplier, or to become involved in or continue with anticompetitive practices. These include: *i)* the use of anticompetitive crossed subsidies, *ii)* generating anticompetitive outcomes using information from competitors, *iii)* not providing other service suppliers with timely technical information regarding essential resources and commercially relevant information.

Under these commitments, Mexico apparently acquiesced to a liberalization of trade in telecommunications services, whereas in its FTAs it had circumscribed its liberalization to trade in telecommunications equipment, and to the provision of value added services.

Even after the 1997 GATS commitments, by 2002 the market structure of the sector denoted limited effects derived from the new, ostensibly more competitive environment. Considering two main effects of competition, v.gr. improved quality of services and reduced prices, the Mexican telecommunications sector did register a significant improvement in the quality of service at the beginning of competition, in part due to significant investment in technology (OECD 1999). Nevertheless, this improvement did not go far enough; in 2001 Mexico's answer seizure ratio was one of the lowest in the OECD context (OECD, 2003). Likewise, even though at the beginning of competition telecommunication tariffs decreased dramatically, especially in long and international long distance, comparing prices with other countries gives a different perspective. Figures 3 and 4 present comparisons on business and residential charges for OECD countries for 1998 and 2002; it is clear that in all cases Mexico's prices were well above the OECD average.

F I G U R E 3

INTERNATIONAL COMPARISON OF BUSINESS AND RESIDENTIAL CHARGES (1998)



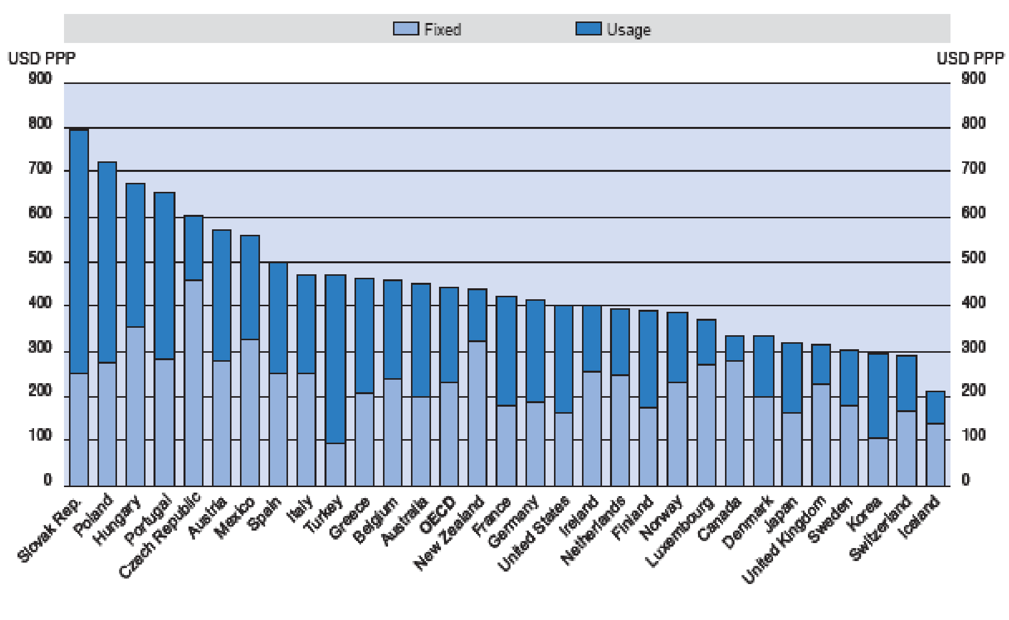
SOURCE: Figures 7.10 and 7.11, OECD *Communications Outlook* 1999 (1999, 178-179).

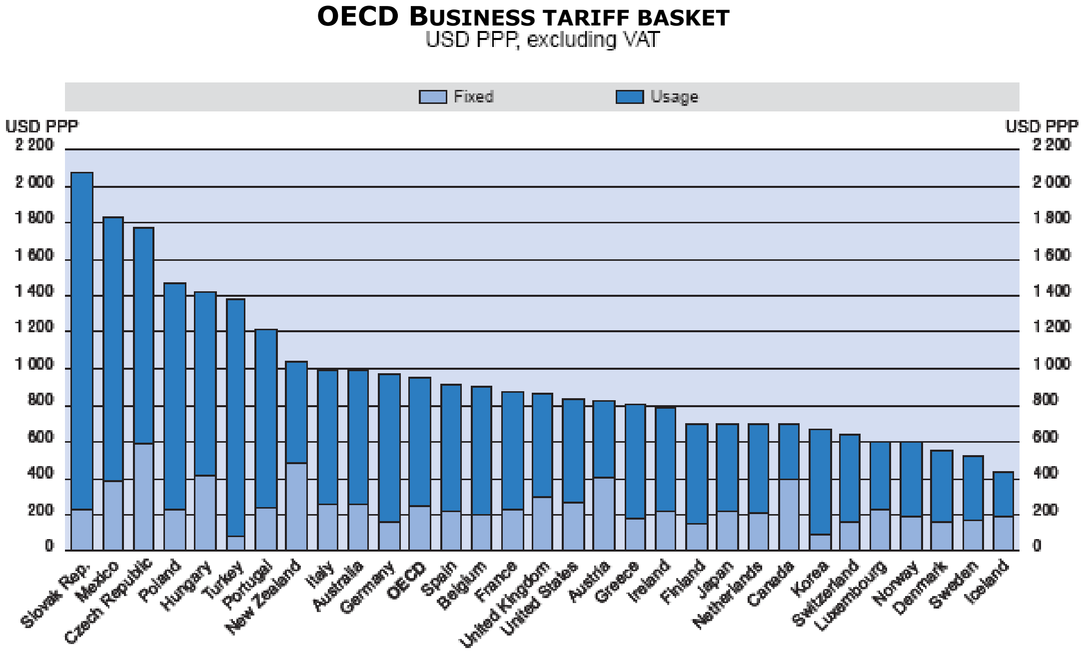
F I G U R E 4

INTERNATIONAL COMPARISON OF BUSINESS AND RESIDENTIAL CHARGES (2002)

OECD RESIDENTIAL TARIFF BASKET

USD PPP, including VAT





SOURCE: Figure 6.4 and 6.6, OECD *Communications Outlook* 2003, (2003, 258-259).

3. The Rationale of the Trade Strategy and the Role of Telecommunications

To understand the reasons for the limited liberalization of the telecommunications sector under the FTAs, and the greater depth and scope of liberalization of telecommunications that Mexico undertook under GATS, we need to take into account the economic and political logic of international economic agreements, which are not infrequently at odds with each other.

NAFTA's content reflects this conflicting economic vs. political logic. From an economic perspective, it was imperative that the agreement guarantee unimpeded access to the U.S. market through the reduction of tariffs and a curtailment of the discretionary use of non-tariff barriers. In addition, a wide scope and coverage was also required, and especially so in the case of trade in services. If the agreement concentrated on the liberalization of trade in goods and largely excluded trade in services, this meant that Mexican good producers would have a very hard time competing under the new environment if some key inputs that were services related (especially those pertaining to financial and telecommunications services) were inefficient and costly as compared to those services in Canada and the U.S. In short, the agreement needed to be economically coherent.

Secondly, the agreement needed to incorporate a political rationale. Since negotiations were not being held exclusively among experts on international economics that were accountable to no one, political pressures for liberalization and protection (both from Mexican and foreign interest groups) had to be accommodated. The challenge was to ensure that the agreement would be ratified while at the same time the basis of the economic logic was not sacrificed for ratification purposes, in which case the result could well be a pyrrhic victory. NAFTA has a very wide scope and coverage but, as mentioned, only telecommunications equipment sales and the supply of value added services were covered; basic telecommunications services were excluded.

It is possible to say that in this case the political logic –and specifically prior legal commitments undertaken by the Mexican government- represented an important sacrifice of the economic logic of the agreement. The limited liberalization of telecommunications was due mainly to the fact that before the conclusion of NAFTA negotiations the Mexican government had undertaken the largest privatisation in its history, namely that of the national telephone company, Teléfonos de México (TELMEX). Under the concession title, the new owner was guaranteed to face limited competition during a transition phase, so that the company could adjust to the new circumstances. In other words, it was clear from the outset of negotiations that given the recent privatisation of TELMEX, Mexico would not agree to the liberalization of trade in telecommunications services under NAFTA.

If the reasons for the limited liberalization of telecommunications services under NAFTA are relatively clear, this is not the case regarding the liberalization undertaken by Mexico under GATS. A first interpretation is that the government wished to continue with a gradual liberalization in order to allow TELMEX to adjust to full competition. This would mean that the dispute with the U.S. is nothing but a misunderstanding, possibly derived from an unfortunate drafting of Mexico's liberalization commitments. The unfortunate drafting could be linked to the positive list approach (whereas under NAFTA the negative list approach was used) and to inadequate coordination between Mexican authorities, which led to an incoherent telecommunications policy formulation process.

A second interpretation leads us to assume that, following an overriding economic logic, certain Mexican authorities actually sought a significant liberalization of telecommunications, and wanted to do it as far as allowed by the TELMEX concession title, but did not want to assume the political costs of such liberalization. A way of minimizing these costs was through the establishment of commitments that could be subject to different interpretations, and leaving the WTO to appear as responsible for this sector's liberalization in Mexico. This way, the WTO would be bear the burden of liberalization, and Mexican authorities could therefore elude unwanted political costs.[5]

Whatever the correct interpretation is, the fact that Mexico's telecommunications sector could be liberalized by means of a report from a WTO panel is inconvenient for the credibility of Mexican trade policy and for the attraction of foreign investment to the sector. "Forced" liberalization is prone to generate political opposition and can be subject to reversals if the opportunity arises.

4. The Mexico-U.S. Telecommunications Dispute

In July 2000, the U.S. Trade Representative (USTR) started a consultation procedure at the WTO, alleging that Mexico was imposing barriers to competitors in that sector. The USTR sustained that, among other matters, there was not an effective discipline to regulate TELMEX, so TELMEX could use its monopoly power to eliminate competitors and avoid that other telephone companies offer their services in the Mexican market. USTR also argued that settlement fees were exceedingly high (Ortiz Mena 2001, 42). The matter was not settled at the consultations phase, and a panel under the WTO Dispute Settlement Understanding reviewed the matter from 2002 to 2004.

The case has generated a great deal of interest, since it is the first one governing trade in telecommunications services. Developed countries (Japan, Canada, Australia, and the European Communities) as well as developing ones (Brazil, India, and some Central American and Caribbean countries) participated as interested third parties. Significant economic interests regarding the Mexico-U.S. long distance route and basic liberalization principles were at stake.

4.1. The Mexico-U.S. Long Distance Route

The Mexico-U.S. route represents approximately 89% of the international long distance Mexican market, and was the second most important route in terms of volume, within the 50 most international routes for the year 2000 (TeleGeography 2001, 100). Outgoing U.S. traffic to Mexico occupies the first place among its main routes, surpassing outgoing traffic to Canada (TeleGeography 2001, 205). Historically this market has been a surplus one for the Mexican market, with a 3:1 ratio of incoming to outgoing calls (TeleGeography 2001, 101).

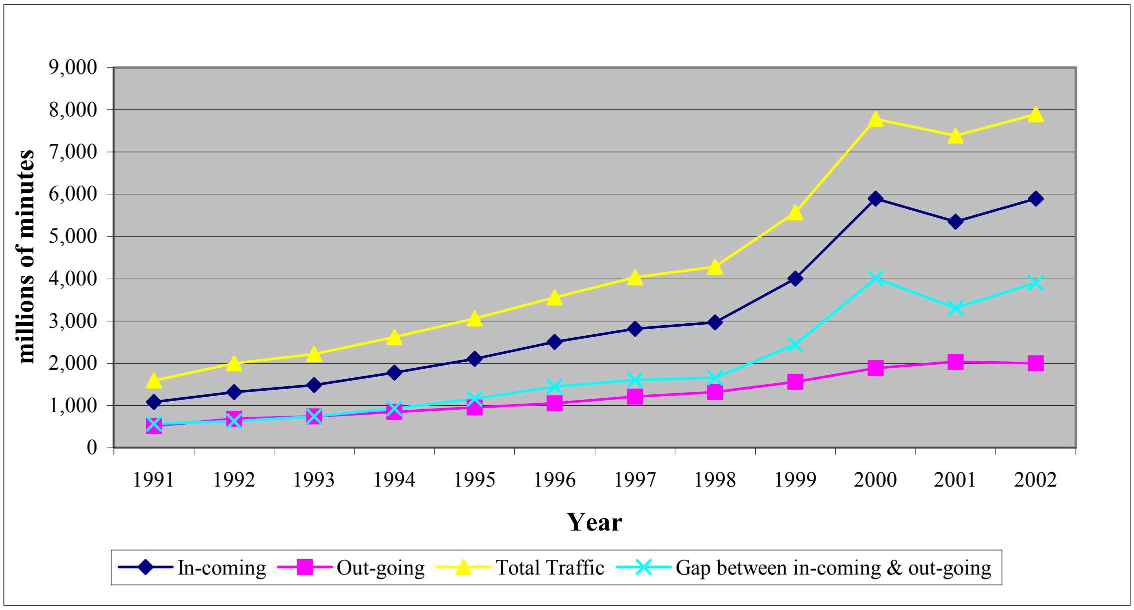
International long distance traffic, measured both as expenditure per line and as total international calls per line present high price and income

[5] We are indebted to an anonymous interviewee from the private sector for suggesting this alternate explanation.

elasticities (Garín Muñoz and Pérez Amaral, 1996), so traffic behavior in this route is a function of the level of economic activity on both sides of the border and the price level offered to the end user.

FIGURE 5

MEXICO-UNITED STATES ROUTE. TRAFFIC FLOWS



Source: Based on data from COFETEL 2003

4.2 The Accounting Rates System

In 1997 an agreement on settlement rates was reached in the GATS negotiations.[6] The agreement establishes that the use of settlement rates would not lead to actions from member countries through the WTO Dispute Settlement Body. This agreement would be checked before starting the new round of service negotiations; in 2000 a new negotiation round on services started, but at least at the beginning of the dispute (2002), no agreement on settlement rates was reached.[7]

The Accounting Rates System (ARS) reform constitutes one of the great challenges for the telecommunications sector, since it represents the transition towards new technologies and resulting agreements for call endings. Essentially, technological developments raise the expectation that the costs of transporting signals will not be affected by distance; nevertheless, even today

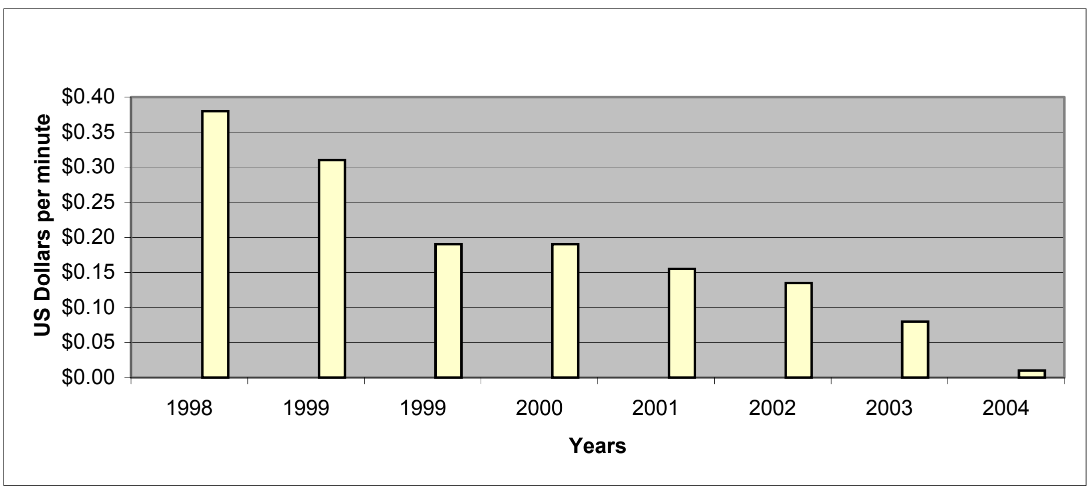
[6] Document S/GBT/4, February 15th 1997.
[7] Late 2003.

public rates for international long distance calls are different for each country or region. The ARS pits developing and developed countries against each other, given that the former often exhibit large deficits. The U.S. government has promoted different unilateral actions to eliminate the ARS, among which the 1997 "Benchmark Order" is of particular interest, setting limits to settlement rates that U.S. operators have to pay for ending international traffic in other countries.

For the Mexico-U.S. route, the settlement rate charged and paid by operators in both countries has had a clear decreasing trend, which started at 40 USD cents per minute in 1997 when competition started in Mexico, ending at less than 1 cent in 2004. This is mainly due to the commercial pressures from main U.S. operators, the unbalanced traffic on that route, and the gap between the fees charged to end users in the two countries. This settlement rate is oriented towards the costs of operating these networks.

F I G U R E 6

MEXICO-UNITED STATES SETTLEMENT RATES



Source: Based on data from COFETEL 2003.

4.3. International Long Distance Service Regulation in Mexico

International long distance service regulation in Mexico started with the service's liberalization in 1997, when the Ministry of Communications and Transportation issued the International Long Distance Rules that public telecommunications network concessionaires must apply through the Federal Telecommunications Commission (Comisión Federal de Telecomunicaciones, COFETEL). ILDR were reviewed given the findings of the WTO panel. These rules had their fundamental basis on the International Telecommunication Union

(ITU)'s International Telecommunications Regulations and on Article 47 of the Federal Telecommunications Law (LFT).

ITU regulations provide that each country has the sovereign right to regulate its telecommunications sector, and establishes general principles related to the supply and operation of international services. Its goal is to simplify telecommunication interconnections and interoperability at a world level, and recommends that the supply and operation of international telecommunications services be made by mutual agreement among administrations. It also guarantees the right each country member has to demand that the administrations operating in its territory and supplying international telecommunications service to the public be duly authorized.

Article 47 of the LFT establishes that only public network concessionaires may install telecommunications equipment and cross-border transmission means, and that the interconnection of public telecommunication networks with foreign networks will be carried out through interconnection agreements negotiated by the parties. When SCT considers that interconnection agreements harm a country's general interests, its end users, or the concessionaires or public networks, it may establish specific modalities to which such agreements shall be subject, in order to incorporate proportionality and reciprocity conditions regarding interconnection services.

The ILDR were based on the creation of two systems: Uniform Settlement Rates[8] and Proportional Returns,[9] as well as on the requirements to operate international ports and authorize interconnection agreements with foreign operators. Three additional elements, apart from the ILDR, play a part in the Mexico-U.S. dispute: the method to fix settlement rates,[10] the treatment given to private traffic,[11] and the concepts used for "traffic" and "network." [12]

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[8] *a)* The same settlement rates are applied by international port operators to the long distance calls originated in a specific country, without taking into account which operator generates them abroad and the concessionaire ending the call on national territory, and;

b) the same settlement rates are applied by operators of a specific country to the long distance calls originated in national territory and delivered by those operators, no matter which long distance concessionaire originated them in national territory and which operator ends them abroad.

[9] The proportional return system as defined by the ILDR is the one through which international port operators distribute the incoming call attempts to national territory, according to the following terms:

a) the total amount of settlements paid by every international port operator to all the operators of a specific country are determined on a monthly basis;

b) the total amount of settlements established in item "a" (above) generated by each international port operator in that period will be determined;

c) international port operators have the right to receive, randomly, the incoming call attempts originating in a given country in any period f the month, with respect to the type of call and according to the percentages established for the previous monthly period under items "a" and "b" (above); and

d) the international port operator that receives a greater volume of incoming traffic than allowed for under item "c" (above) shall, on a random basis *(i)* keep the amount of incoming call attempts corresponding to him and (ii) distribute the exceeding incoming call attempts to each one of the international port operators to satisfy the established percentages.

[10] Rule 13 grants the operator with the largest market share the opportunity to negotiate the rate. The long distance concessionaire with the largest outgoing calls market share, in the six months previous to the negotiation, is

The ILDR worked under the concept of switched-circuit international traffic, which assumes there is a single type of technology available for long distance service supply. However, new technologies such as signal packaging and voice over IP are flourishing and creating a significant black market in the international long distance service field.[13]

4.4 The WTO Dispute Settlement Panel

4.4.1 USTR and Mexican Government Positions

While the GATT/WTO dispute settlement mechanism has overseen approximately 300 disputes involving trade in goods, this is the first case over international trade in services, and it is not surprising that it has been on telecommunications services. The dispute has generated interest among both developed and developing countries, given the potential effect the case may have on settlement systems and on the world-wide provision of international telecommunications services.

A synthesis of USTR complaints and Mexican government positions renders the following:[14]

i) *The settlement rates are not low enough nor are they cost oriented.* The argument is essentially based on the rationale that settlement rates are the same as interconnection fees, and that Mexico undertook specific commitments in the Reference Paper.[15]

The USTR argues that Mexico's Commitments List, adopted as additional commitments in the Reference Paper, which in its section 2 (Interconnection), paragraph 2.2, states that the interconnection with a main provider will be ensured on any technically feasible point in the network, and that such interconnection will take place in an appropriate manner, in the terms, conditions (including technical norms and

the one allowed to negotiate the settlement rates with that country's operators. These rates are then submitted for COFETEL's approval.

[11] Private traffic is assigned to private networks, meaning that it is forbidden to route public traffic through private networks; the payment of settlement rates is compulsory.

[12] Rule 4 establishes that in order to establish a private cross border network there is a need to lease a concessionaire's long distance service capacity, and that cross-border traffic transported through the infrastructure that is part of a private network shall originate and end within the same network.

[13] According to TeleGeography Research, U.S. traffic towards Mexico through these networks in 2000 exceeded six million minutes, occupying the first place in U.S. outbound traffic (TeleGeography 2000, 66).

[14] WTO Mexico – Measures Affecting Telecommunications services. Request for the Establishment of a Panel by the United States, WTO/DS204/3.

[15] [The Reference Paper on Regulatory Principles covers regulatory aspects of GATS' Basic Telecommunications Agreement, and entered into force on February 8, 1998. Mexico adopted all the Reference Paper provisions except for those on resale (WTO 1996).

specifications) and cost-based rates that are transparent, reasonable, economically feasible and disaggregated enough so that the provider does not need to buy components or network resources that are not required for the service to be supplied.

The ILDR allowed the connection from a public telecommunications network from any Mexican long distance concessionaire to a foreign network through an international port with a uniform settlement rate for each route. For cross border supply and commercial presence, international traffic must be routed through the installations of a firm holding a concession. Therefore, cross-border supply that involves a settlement rate was not treated as a national interconnection, which uses interconnection rates. The Mexican claim is that the U.S. government wants Mexico to treat national interconnection and cross border supply in a like manner, in order to reduce the costs faced by U.S. operators to carry out traffic into Mexico.

ii) The ILDR granted the dominant Mexican telephone company an exclusive and anti-competitive right to negotiate the cross-border interconnection rate. The operator facing the greatest market volume is the one who negotiates the settlement rates, as established by ILDR Rule 13. Therefore, the Mexican government is not only covering up anticompetitive practices, but also openly violating its GATS commitments.

According to the Reference Paper, specifically section 1.1 (Competitive Safeguards), paragraph 1.1, appropriate measures shall be maintained, for the purpose of preventing providers to constitute, individually or as a group, as the main provider, to get involved in or continue to perform anticompetitive practices.

In USTR's view the ILDR, and specifically Rules 13 and 23, infringe the competitive safeguards commitment previously mentioned. Rule 13 provides that the long distance concessionaire which has the greatest share of the outgoing long distance calls in the previous six months with a specific country will be the one to negotiate the settlement rates with the country's operators, and that rates shall be submitted for COFETEL approval. Rule 23 establishes that under agreements held with foreign operators, the principles of uniform settlement rates and proportional returns must be observed.

For the USTR, these rules in and of themselves constitute anticompetitive practices, for they restrict the negotiation of a settlement rate exclusively to the concessionaire that was the leading one for the last six months, forcing the rest of long distance concessionaires to negotiate their rates in a bilateral way and thus violating their right to free competition.

The Mexican position was that the ILDR set up a market participation mechanism for the negotiation of the settlement rate for a specific route (Rule 13), and that there was no commitment regarding the settlement rate. In addition, it noted that the U.S. government *de facto* applied a similar regulation where the "best" rate obtained in the market is the one that has to be applied by the rest of interconnected operators in a fixed route. Considering that the "best" rate for operators with a deficit will always be the lowest one, the operator that always negotiates with the Mexican enterprise is the one that has the greatest U.S. market share.[16]

iii) *Foreign suppliers are discriminated against regarding line leasing*. The regulation scheme of dedicated lines is discriminatory, given that enterprises re-selling international traffic are not allowed to operate in Mexico if they don't have a concession or authorization for international long distance. This means that trading firms without their own infrastructure are not authorized (i.e. international simple resale is not authorized).

The Mexican government's position was that the ILDR allow every Mexican long distance concessionaire with a foreign network the connection to a public telecommunications network through an international port and with a uniform settlement rate for each route. In order to offer cross-border supply and be able to have commercial presence in Mexican territory, international traffic must be routed through a legally constituted enterprise's installations which also holds a concession to supply long distance services.

The Mexican government wanted to maintain the legal and regulatory framework, and therefore held that the commitment offer explicitly defines that, for cross-border supply, international traffic must be routed through the installations of a concessionaire and that, accordingly, national treatment is granted.

The Mexican government's position was that the elimination of measures contained in the ILDR was not a commitment it undertook, given that for cross-border supply international traffic must be routed though a firm holding a concession awarded by SCT, as set out in Mexico's Commitments List. In other words, the argument is that the Mexican government did not commit to liberalizing competition for the international supply of telecommunications services, which evidently includes basic telecommunications services from another country into Mexico.

[16] Historically, the settlement rate between Mexico and the U.S. has been negotiated between AT&T and TELMEX; only more recently did MCI World Com intervene.

More generally, the Mexican government argued that only Mexican authorities, taking into account the public interest, industry interests, national consumers, and international commitments would determine if there is a need to modify the ILDR. Three issues were of paramount concern in this regard: the general public interest of having international long distance services at lower rates, the benefits generated by the proportional return system and uniform settlement rates under current ILDR, and maintaining the surplus in international long distance telephone services.

The settlement system and accounting rates that govern international voice services from the outset of telephony are the best example of the type of problems arising in international telecommunications service trade between developed and developing countries. While the former seek to reduce payments for ending international traffic, the latter seek to maintain the benefits of receiving a higher number of calls than the ones they make. The argument can be made that the ones using networks and telecommunications services more intensively should pay more than the others.

Nevertheless, it is important to recognize that technological change is resulting in new channels to route traffic and result in lower costs for operators and potentially lower prices for consumers, and that this entails the need to adjust the national regulatory framework to the new technologically-driven realities.

Important issues are still at stake in the WTO telecommunications dispute, among them the liberalization of the Mexican telecommunications sector, regulations involving access to the telecommunications market, the way technological changes should be reflected in regulations, and the potential impact of these issues on Latin American telecommunications markets.

4.4.2 The Report on Mexico-Measures Affecting Telecommunications Services

On April 2, 2004 the report of the WTO panel that reviewed Mexico's measures affecting telecommunications services was circulated to all WTO members. On the basis of the panel's findings, the report presents seven conclusions, with the recommendation that Mexico bring its measures into conformity with its GATS obligations in those instances where it was found to be in violation of such obligations.

From the Report's seven conclusions, four are against the Mexican government's position and three against USTR claims (WTO 2004, 224-226). The conclusions against the Mexican government are the following:

1) "Mexico has not met its GATS commitments under Section 2.2(b) of its Reference Paper since it fails to ensure that a major supplier provides interconnection at cost-oriented rates to United States suppliers for the

cross-border supply, on a facilities basis in Mexico, of the basic telecommunications services at issue." Mexico is thus violating its commitments expressed in the Reference Paper on Regulatory Principles which established the obligation to ensure that interconnection with a major supplier be at cost-oriented rates.

2) "Mexico has not met its GATS commitments under Section 1.1 of its Reference Paper to maintain "appropriate measures" to prevent anti-competitive practices, since it maintains measures that require anti-competitive practices among competing suppliers which, alone or together, are a major supplier of the services at issue." The Mexican government has thus not provided appropriate measures to prevent anti-competitive practices, since it maintains Rule 13 of its ILDR, which grants the operator facing the greatest market volume the right to negotiate the settlement rates.

3) "Mexico has not met its obligations under Section 5(a) of the GATS Annex on Telecommunications since it fails to ensure access to and use of public telecommunications transport networks and services on reasonable terms to United States service suppliers for the cross-border supply, on a facilities basis in Mexico, of the basic telecommunications services at issue."

4) "Mexico has not met its obligations under Section 5(b) of the GATS Annex on Telecommunications, since it fails to ensure that United States commercial agencies, whose commercial presence Mexico has committed to allow, have access to and use of private leased circuits within or across the border of Mexico, and are permitted to interconnect these circuits to public telecommunications transport networks and services or with circuits of other service suppliers." The Mexican government has thus not met its obligations under the GATS Annex on Telecommunications, with respect to access and use of private lease line circuits (dedicated lines).

The Fifth, Sixth and Seventh conclusions are contrary to USTR claims, and express that the Mexican government has not violated any of its commitments regarding the cross-border supply of international long distance basic telecommunications services, based on non-facilities in Mexican territory and therefore holding a concession, which means that the panel has not recognized the right of trading telecommunications services firms to render services in Mexico without owning infrastructure. In other words, it has not recognized international simple resale. Specifically, the conclusions state that:

5) "Mexico has not violated Section 2.2(b) of its Reference Paper, with respect to cross-border supply, on a *non-facilities* basis in Mexico, of the basic telecommunications services at issue;"

6) "Mexico has not violated Section 5(a) of the GATS Annex on Telecommunications, with respect to the cross-border supply, on a *non-*

facilities basis in Mexico, of the basic telecommunications services at issue;" and

7) "Mexico has not violated Section 5(b) of the GATS Annex on Telecommunications, with respect to the cross-border supply, on a *non-facilities* basis into Mexico, of the basic telecommunications services at issue."

The Mexican government gave up its right to appeal the report, and decided to comply with the recommendations. Accordingly, on June 15, 2004 COFETEL issued a new set of rules for regulating international long distance services in Mexico, the Rules for International Telecommunications (RIT). These new rules substitute the former ILDR, eliminating both the Uniform Settlement Rate and the Proportional Return System, liberalizing the method to fix settlement rates and providing that each operator competitively negotiate with his foreign counterpart the most convenient rate for each type of service and route.

The new RIT abandoned the limited concept of switched-circuit international traffic, providing that international traffic could be routed through new technologies, but maintains the obligation to route the cross-border supply of international public traffic through a firm holding a concession, which means facilities-based. With the new RIT every operator will negotiate its most convenient settlement rate, so the rate should fall dramatically and conform with WTO cost-oriented and anti competitive practices obligations.

More generally, the results of this panel will define the rules that govern trade in telecommunications under the WTO, specially for international long distance services and the accounting rate regime, and has the potential to redefine the relation between developed and developing countries in this particular service, given the large deficits and surpluses at stake.

5. The Challenges

The basic challenge is to achieve an agreement with wide consensus among government, business and consumers, regarding the role telecommunications ought to play in Mexico's economic and social development, and on the strategies that should be followed to attain the desired objectives. This is a basic issue, but an important degree of dissent among key players in the telecommunications debate has made it difficult to develop a coherent policy on the matter, be it international or domestic telecommunications policy.

While great potential costs associated with untrammelled competition under an environment of unsound regulation in the telecommunications sector are all too evident, and every country has specific needs and specific solutions to this challenge, this should not constitute an excuse to allow anticompetitive practices that deter the healthy development of the telecommunications sector and which can constitute a drag on economic growth and overall competitiveness.

Specifically, two issues must be addressed in the short and medium term: the WTO dispute and the telecommunications policy formulation process.

Regarding the WTO dispute, after the panel's unfavourable report towards several of the Mexican government's positions, reasonable and in-depth changes in the regulatory framework are needed to comply with the resolution and, no less importantly, to secure the sector's competitiveness.

One of the main considerations behind the promotion of new regulations for international long distance services, as expressed in the RIT, was to benefit consumers by generating incentives for the provision of improved telecommunication services in terms or price, quality, and variety. Given the key role that telecommunications play in the overall competitiveness of the Mexican economy, it is regrettable that the government waited until the WTO panel issued its final report to bring its regulations in line with the needs of consumers.

Even now, in light of the pace of technological developments in the sector, it is still unclear if the Mexican government will be able to foster continued improvements from a consumer-based perspective in the medium and long-term. The Mexican government should consider the salutary effects of supplying international long distance services at lower rates, while taking into consideration the adverse effects that regulatory changes may have on the long-standing trade surplus in international long distance services.

Therefore, Mexico's telecommunications policy formulation process must be deeply reviewed so that greater complementarities in the aims and strategies favored by the institutions that participate in the policy formulation and implementation process are attained. Particularly, there is a need to define the faculties and interaction modalities of SCT, COFETEL, the Federal Competition Commission (CFC), the Economics Ministry (SE), the legislature, and relevant business organizations as regards telecommunications policy. They must coordinate in a much better way, so situations such as that which brought Mexico into the WTO telecommunications dispute are avoided.

More generally, if a broad, long-term consensus regarding the sector's basic goals and the path to attain them is not reached, telecommunications in Mexico could become a hindrance instead of a catalyst for economic growth and competitiveness.

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